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No. [redacted] 1

In the Supreme Court of the United States

OCTOBER TERM, 1934

EDWARD B. DOUGLAS, PETITIONER

v.

LEVI M. WILLCUTS, AS COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF MINNESOTA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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No. 541

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OPINIONS BELOW

No opinion was rendered by the District Court. The opinion of the Circuit Court of Appeals (R. 83–88) is as yet unreported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered September 13, 1934 (R. 88). A petition for rehearing was denied October 22, 1934 (R. 97). The petition for a writ of certiorari was filed November 26, 1934. The jurisdiction of this Court

is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayer created an irrevocable trust to pay specified amounts annually out of the income thereof to his wife during her life in lieu of alimony, retaining all other interests in the trust to himself. Is he taxable as to such income as was in fact so distributed?

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved appear in the Appendix, *infra,* pp. 7–9.

STATEMENT

The facts as found by the District Court (R. 57–63) and as they appear in the opinion of the Circuit Court of Appeals (R. 83–88) may be summarized as follows:

On September 12, 1923, the taxpayer created a trust to pay out of the net income thereof to his wife $15,000 annually until November 6, 1927, and thereafter $21,000 for life. The taxpayer reserved to himself, with certain qualifications,[1] the entire corpus as well as the excess income (R. 84).

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[1] In the event that the net income should be insufficient to make such payments, the husband agreed to make good such deficiency upon request, or in default thereof, such deficiency to be made up from the principal of the fund. In the case of excess net income, the trustee might reserve therefrom reasonable amounts fairly to insure the promptness of future payments.

The wife agreed to accept such payments in lieu of and in full settlement of alimony. The divorce decree entered three days later incorporated that agreement (R. 85).

In 1927 and 1928 the taxpayer failed to report in his individual income-tax returns income realized by the trust and paid to his divorced wife pursuant to the trust agreement. The Commissioner determined that such amounts constituted taxable income to the petitioner, and the tax was paid under protest. In a suit for refund the District Court refused to uphold the Commissioner's determination, but its judgment was reversed by the Circuit Court of Appeals.

ARGUMENT

This case involves the narrow question whether the grantor of an irrevocable trust is accountable for the income therefrom to the extent that it is applied to free him of a legal obligation. The trust instrument in this case provided for fixed payments to the grantor's wife which she agreed to accept in lieu of, and in full settlement of alimony. The divorce decree, issued shortly after the execution of the trust indenture, incorporated that agreement. There seems but little room for doubt that the income of the trust, so employed, discharged *pro tanto* an obligation that the grantor was bound to meet.

The petitioner cites many decisions of this Court and of Circuit Courts of Appeals as being in con-

flict with the decision below. Those cases, however, do not appear to have any very close connection with the instant case. In none of them was the present issue raised.

The decision below is in accord with the well-settled principle that the payment of one's obligation by another may constitute taxable income to him whose obligation is discharged. *Old Colony Trust Co.* v. *Commissioner,* 279 U. S. 716; *United States* v. *Boston & Maine R. R. Co.,* 279 U. S. 732; *United States* v. *Mahoning Coal R. R. Co.,* 51 F. (2d) 208 (C. C. A. 6th), certiorari denied, 285 U. S. 559.

The Government's position is further strengthened by the statutory prohibition against deductions for personal or family expenses. Section 215 (a)(1) of the Revenue Act of 1926, *infra,* p. 7. These provisions have been consistently construed to prevent a deduction for alimony. Regulations 69, Article 291, *infra,* p. 9; Regulations 74, Article 281, *infra,* p. 9. If the petitioner is correct on the merits, anyone with income-producing property could render that provision meaningless by a trust irrevocable as to such income as must be applied to discharge his personal obligations. The validity of a specific legislative declaration that income so applied should be deemed to be devoted to the grantor's use could scarcely be doubted. *Burnet* v. *Wells,* 289 U. S. 670, 682. One can hardly assign to Congress any intent to permit such circumvention, especially where the statutory definition of

gross income is sufficiently broad to include such income.

The decision of this Court in *Helvering* v. *Butterworth*, 290 U. S. 365, cited by the petitioner (Br. 21), is not authority to the contrary. The trusts there involved were established by will and the question presented was whether the income was taxable to the fiduciary or the beneficiary. The tax liability of the testator was not involved. Here the trust was created *inter vivos* and the income, by direction of the grantor, was used to satisfy his legal obligations. As this Court declared in the *Butterworth* case, Congress did not intend that any income from a trust should escape taxation unless definitely exempted. Under Section 219 (b) (2) of the Revenue Act of 1926 (*infra*, p. 8), and Section 162 (b) of the Revenue Act of 1928 (*infra*, p. 9), the fiduciary is permitted to deduct income which is to be distributed currently to the beneficiary. In *Gould* v. *Gould*, 245 U. S. 151, this Court held that alimony payments do not decrease the taxable income of the husband and, further, that they do not constitute taxable income to the wife. And the Board of Tax Appeals has held that the latter principle applies to payments received by the wife through the medium of a trust. *Mary R. Spencer* v. *Commissioner*, 20 B. T. A. 58. Relying upon this Court's decision in the *Gould* case, the Circuit Court of Appeals for the Second Circuit has determined that the income from a trust used

to pay alimony was taxable to the grantor. *Frank Turner* v. *Commissioner*, 71 F. (2d) 1018.

We submit that the decision in the *Butterworth* case does not apply in every situation where a trust has been created, and does not compel income in every case to be taxable, either to the fiduciary or the beneficiary. Certainly it would not be applicable to income from a trust over which the grantor retains a power of control. Cf. *Corliss* v. *Bowers*, 281 U. S. 376. Similarly, it should not operate to relieve from taxation income devoted to the payment of a legal obligation of the grantor.

CONCLUSION

The decision of the court below is correct. It is respectfully submitted that the petition should be denied.

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DECEMBER 1934.

APPENDIX

Revenue Act of 1926, c. 27, 44 Stat. 9:

SEC. 213. * * *

(a) The term "gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities; or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * * (U. S. C. App., Title 26, Sec. 954.)

SEC. 215. (a) In computing net income no deduction shall in any case be allowed in respect of—

(1) Personal, living, or family expenses; * * * (U. S. C. App., Title 26, Sec. 956.)

SEC. 219. (a) The tax imposed by Parts I and II of this title shall apply to the income of estates or of any kind of property held in trust, including—

* * * * *

(2) Income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

* * * * *

(b) Except as otherwise provided in subdivisions (g) and (h), the tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary. The net income of the estate or trust shall be computed in the same manner and on the same basis as provided in section 212, except that—

* * * * *

(2) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, and the amount of the income collected by a guardian of an infant which is to be held or distributed as the court may direct, but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. Any amount allowed as a deduction under this paragraph shall not be allowed as a deduction under paragraph (3) in the same or any succeeding year;

(3) In the case of income received by estates of deceased persons during the period of administration or settlement of the estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir, or beneficiary.

* * * * *

> (h) Where any part of the income of a trust may, in the discretion of the grantor of the trust, either alone or in conjunction with any person not a beneficiary of the trust, be distributed to the grantor or be held or accumulated for future distribution to him, * * * such part of the income of the trust shall be included in computing the net income of the grantor. (U. S. C. App., Title 26, Sec. 960.)

To the extent that they are material, the corresponding sections (22 (a), 24 (a), 162 (b), 167) of the Revenue Act of 1928, c. 852, 45 Stat. 791, 797, 802, 838, 840, are substantially identical with the above.

Treasury Regulations 69, issued under the Revenue Act of 1926:

> ART. 291. *Personal and family expenses.*—* * * Alimony and an allowance paid under a separation agreement are not deductible from gross income. * * *

This statement is also contained in Article 281 of Treasury Regulations 74, issued under the Revenue Act of 1928.

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